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FILE NO. S-589

HORSE RACING:
Illinois Racing Board
Power to indemnify private
corporation

Honorable Anthony Scariano
Chairman
Illinois Racing Board
Room 1000 State of Illinois Building
160 North LaSalle Street
Chicago, Illinois 60601

Dear Mr. Scariano:

I have your letter pertaining to the proposed dissolution of the Illinois Bureau of Race Track Police, Incorporated, an Illinois not-for-profit corporation [hereinafter referred to as Bureau]. In your letter you state, in part, as follows:

"Over the past years, the Bureau has performed three functions:

1. Provided security at race tracks
2. Provided the services of horse identifiers
3. Operated the laboratory which conducts urine and saliva tests of horses.

Representatives of the Illinois Racing Board have served on the Bureau's Board of Directors. Last summer, legislation was enacted which provides that security functions will be taken over by race tracks themselves and that investigative services at the tracks will be provided by the Illinois Bureau of Investigation. In view of this legislation, last year the Racing Board decided that the Bureau should be dissolved and that the functions of providing horse identifier services and operating the laboratory should be transferred to the Racing Board. It is our understanding that those assets of the Bureau which dealt with security functions have already been transferred to the Department of Law Enforcement. As of January 15, 1973, the Racing Board has taken over the functions of providing horse identifiers and operating the laboratory; the personnel performing those functions are now on the racing Board payroll.

The Bureau, itself, has not yet been dissolved. It is our understanding that the Board of Directors of the Bureau has been considering making provisions for the Bureau's liability during the period following the Bureau's dissolution. Apparently, there are several pieces of litigation currently pending against the Bureau. We have been informed that the Board of Directors of the Bureau proposes to place a certain amount of funds into an escrow account to provide for these potential liabilities.

When the Bureau is dissolved, all of the assets of the Bureau, which consist primarily of accounts receivable and the laboratory equipment, will be acquired by the Racing Board. We respectfully request an opinion

> from your office as to whether, upon acquiring these assets, the Racing Board has the power to indemnify the Bureau from any future liabilities. Such indemnification would alleviate the necessity of putting any funds into an escrow account. These funds, as assets of the Bureau, would then also be acquired by the Racing Board and would be paid into the General Revenue Fund."

It is my opinion that the Racing Board cannot enter into such an indemnification agreement nor can it purchase the accounts of the Illinois Bureau of Race Track Police, Incorporated, a not-for-profit corporation, as referred to in your letter.

Section 1(a) and (b) of article VIII of the Illinois Constitution of 1970 provide as follows:

> "(a) Public funds, property or credit shall be used only for public purposes.
>
> (b) The State, units of local government and school districts shall incur obligations for payment or make payments from public funds only as authorized by law or ordinance."

Section 1(a) and (b) of article VIII originated as section 1 of Proposal No. 1 of the Committee on Revenue and Finance of the Sixth Illinois Constitutional Convention. (VII,

6th Ill. Const. Con., Comm. Proposals, pp. 2009-2010 (1972). Section 1 was approved by the Convention without amendment. (II, 6th Ill. Const. Con., verbatim transcript, p. 899 (1972)). Thus, the changes made in the language of section 1 of Proposal No. 1 were stylistic rather than substantive.

It should be noted that the first paragraph of section 1 of Proposal No. 1 evolved into section 1(a) of article VIII while the second and final paragraph evolved into section 1(b) of article VIII. Section 1(c) of article VIII stemmed from section 2 of Proposal No. 1.

The Committee on Revenue and Finance explained its proposed section 1 as follows:

> "Explanation
>
> The first sentence limits the use of public funds, property and credit to a public purpose. It permits the state and its political subdivisions to enter into financial arrangements with governmental or non-governmental organizations whenever a public purpose will be served thereby. In this context, a public purpose is served whenever the appropriation is to be used for governmental purposes and a non-governmental organization is essentially a conduit or agent of the state in implementing its governmental purposes.

The second sentence assigns control over the authority to obligate and disburse public funds to the legislative bodies of state and local government and permits them to delegate such authority only by the enactment of laws.

Present Provisions and Reasons for Change

Article IV, Section 20, of the present constitution prohibits the state from assuming the debts of or loaning credit to any public or private corporation or individual. Illinois courts have rarely utilized this section to prevent state financial aid to private persons or institutions. Schuler v. Board of Education, 370 Ill. 107 (1938). Instead, the courts have developed the public purpose doctrine to determine whether a given transaction accomplishes a proper governmental function. People ex rel Douglas v. Barrett, 370 Ill. 464 (1939); Cremer v. Peoria Housing Authority, 399 Ill. 579 (1948). The proposed language removes the prohibition against assuming debts or loaning credit and substitutes the public purpose test. It also specifically applies the public purpose test to expenditures of local governments.

The second sentence of proposed Section 1 is similar to the provision in present Section 19 of Article IV, which requires that agents of government have express authority to bind the government. While this language may appear to state the obvious, the traditional separation of powers doctrine makes it important to specify which branch of government--in this case the legislature--has the sole authority to obligate or expend funds. The judicial and executive branches may make decisions which affect expenditure of funds, but they do not have the power to authorize the expenditure."

VII, 6th Ill. Const. Con., Comm. Proposals, pp. 2009, 2011 (1972).

In your letter, you point out that the Bureau is contemplating dissolution. You ask whether the Illinois Racing Board [hereinafter referred to as Board] may acquire the assets of the Bureau, which consists mainly of accounts receivable and laboratory equipment. As consideration for the assets of the Bureau, the Board wishes to indemnify the Bureau from any future liabilities; thus the Bureau will not have to maintain an escrow fund to pay off such future liabilities as may accrue.

I am of the opinion that such an indemnification plan would be in violation of both section 1(a) and (b) of article VIII of the Illinois Constitution of 1970.

It should be kept in mind that section 1(a) of article VIII stemmed from section 20 of article IV of the Illinois Constitution of 1870. Section 19 of article IV of the Illinois Constitution of 1870 was basically the constitutional predecessor to section 1(b) of article VIII. The cases interpreting these sections of the Constitution of 1870 will be relied upon in attempting to clarify my holding that

your proposed indemnity plan violates both sections 1(a) and (b) of article VIII.

An agreement by the Board to indemnify the Bureau would constitute an extension of the public credit. In Continental Natl. Bank v. Ill. State Toll Highway Comm., 42 Ill. 2d 385, the Illinois Supreme Court discussed the object and purpose of section 20 of article IV of the Illinois Constitution of 1870. At page 403, the court states:

> "* * * the purpose of the provision, which is complementary to section 18 of article IV, is to prohibit the State from contracting debts as a guarantor or surety so as to protect the State from incurring an excessive public indebtedness. (See Hagler v. Small, 307 Ill. 460, 467, 473; Fairbank v. Stratton, 14 Ill. 2d 307, 315.) * * *"

Thus, an agreement by the State to be a surety or guarantor would be an extension of the public credit.

In a guaranty contract, the guarantor promises the creditor to pay the debt, if and when, the debtor fails to make good his promise to pay. (Thomas v. Williams, 173 Okla. 601, 49 P. 2d 557; Olson v. Smith, 72 S.W. 2d 650, (Tex. Civ.

App.)). In a suretyship contract, again the promise runs from the surety to the creditor. (Maine Lbr. Co. v. Maryland Casualty Co., 214 N.Y.S. 621, 216 App. Div. 35; New Amsterdam Casualty Co. v. Waller, 233 N.C. 536, 64 S.E. 2d 826).

In an indemnity contract, the indemnitor agrees to save the debtor harmless from loss or liability. (Erickson v. Fitzgerald, 342 Ill. App. 223; Maine Lbr. Co. v. Maryland Casualty Co., 214 N.Y.S. 621, 216 App. Div. 35; New Amsterdam Casualty Co. v. Waller, 233 N.C. 536, 64 S.E. 2d 826). Thus, in an indemnity contract the promise runs to the debtor whereas in a surety contract or guaranty contract the promise runs to the creditor.

In Continental Natl. Bank v. Ill. State Toll Highway Comm., 42 Ill. 2d 385, the Illinois Supreme Court held that where the State undertakes to contract debts as a guarantor or surety the public credit is involved. I am of the opinion that an indemnity contract extends the public credit as well. The key is that in an indemnity contract, as well as in a surety or guaranty contract, public funds may at some time in the future be expended.

Section 1(b) of article VIII prohibits the incurring of an obligation except as provided by law. The General Assembly controls the obligation of public funds but it may delegate this authority. Thus, before the Board may enter into an indemnity contract such as is contemplated in your letter, the Board must have the statutory authority to enter into such a contract.

The Illinois Court of Claims in construing section 19 of article IV of the Illinois Constitution of 1870 has held that the State may not enter into an agreement to indemnify a railroad where no express authority to make the indemnity contract exists. Illinois Central R.R. Co. v. State of Illinois, 21 Court of Claims Rep., 25.

I am of the opinion that the Board has not been authorized by the legislature to enter into the proposed indemnity agreement. Therefore, said agreement if entered into would be illegal and void.

Furthermore, the General Assembly appropriates to the Board a certain amount of money each fiscal year. Obviously, the Board does not have the power to expend more than

has been appropriated to the Board. The authority of a State agency to incur obligations, even though within the general scope of the functions imposed upon it by law, is, by and large, limited to the amount of the existing appropriations made to that agency; and, generally, if the appropriations are insufficient to meet the obligations incurred, the contract creating the obligation is void as being made without express authority of law. (Fergus v. Brady, 277 Ill. 272). Here, the Board is both proposing to enter into an indemnity contract that it does not have the authority to make; and that contract would be open-ended so as to make the State responsible for payment of an unknown amount of money that could exceed the appropriation granted to the Board.

The proposed plan whereby the Board would purchase the Bureau's assets, including the accounts receivable, in return for the Board agreeing to indemnify the Bureau, is in violation of section 1(a) of article VIII. The proposed agreement as pointed out earlier would constitute a use of public credit but it would not be for a public purpose.

The Illinois Supreme Court has held on a number of occasions that if the principal purpose and objective of an enactment is public in nature, it does not matter that there will be an incidental benefit to private interests. (People ex rel. Adamowski v. Chicago R.R. Terminal Authority, 14 Ill. 2d 230, 236; People ex rel. Gutknecht v. City of Chicago, 414 Ill. 600, 611; Poole v. City of Kankakee, 406 Ill. 521, 530; Cremer v. Peoria Housing Authority, 399 Ill. 579, 591-592). There is no legislation authorizing the Board to extend the credit of the State by way of an indemnity contract when the major purpose of the extension of the credit of the State is to benefit a private not-for-profit corporation. The Board receives only the incidental benefit of obtaining laboratory equipment that it can use to carry out its statutory duties. Apparently, however, this equipment is not so unique that it must be obtained from the Bureau. Even if it were unique, it could be obtained by financial arrangements other than the proposed indemnity agreement. Clearly, the purpose of the indemnity agreement is to benefit the Bureau rather than the public. By this method, the Bureau will be free of collecting its accounts receivable and will not have to maintain an escrow

fund to pay off future liabilities.

You have also noted that the Board intends to purchase the accounts receivable of the Bureau. Even apart from the proposed indemnity plan such a proposal would be illegal.

It is a well established principle that an administrative agency derives its powers and authority only from the statute creating it and it, therefore, has only the authority which is expressly conferred upon it. (People ex rel. Polen v. Hoehler, 405 Ill. 322; 1 I.L.P., Administrative Law and Procedure, sec. 21, p. 452 (1953)). However, an express grant of power to do a particular thing includes the grant of power to do all that is reasonably necessary to execute the power or duty. Townsen v. Gash, 267 Ill. 578.

The Illinois Racing Board does not have the statutory authority to purchase the accounts receivable of a private corporation. Clearly, such a purchase could not aid the Board in the execution of its powers and duties.

Therefore, I am of the opinion that the Illinois Racing Board may not indemnify the Illinois Bureau of Race

Track Police, Incorporated, as to the future liabilities that may arise or become due subsequent to the Bureau's dissolution as a not-for-profit corporation.

Very truly yours,

ATTORNEY GENERAL